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Delaware Corporation Law Now Prohibits "Fee-Shifting," Allows Limited "Forum Selection"

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On June 24, 2015, the Delaware State Legislature enacted various amendments to the General Corporation Law of the State of Delaware (the "DGCL"), which resolved two increasingly controversial issues of corporate governance. The amendments will become effective August 1, 2015.

Fee-Shifting

A recent controversy in corporate governance has been the propriety of including in a corporation's certificate of incorporation or bylaws a provision to the effect that in litigation brought by stockholders against the corporation or its directors and officers, including actions for breach of fiduciary duty and derivative suits, the plaintiff stockholder, if unsuccessful, would be required to pay the legal fees of the defendant corporation, directors and officers—i.e. "fee-shifting" or "loser pays" provisions. One of the primary purposes of such provisions is to dissuade stockholders (including "professional plaintiffs") from bringing abusive lawsuits. On the other hand, opponents of these provisions believe that they discourage stockholders from bringing legitimate claims, which, over decades, have resulted in a sophisticated body of case law on the fiduciary duties of directors.

The amendments to the DGCL effectively prohibit fee-shifting provisions in the corporate documents of stock corporations, as follows:

1. Section 115 is added to the DGCL, which, among other things, contains the newly defined term "internal corporate claims," meaning:

   "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery" [in general, claims arising under the DGCL].

2. Section 102, relating to the certificate of incorporation, and Section 109, relating to corporate bylaws, are amended to provide, respectively, that these corporate documents "may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in §115 of this title."

These amendments effectively overrule, with respect to stock corporations, *ATP Tour, Inc., v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), in which the Delaware Supreme Court upheld a fee-shifting bylaw of a non-stock corporation. It is noted that these amendments do not prohibit the inclusion of a fee-shifting provision in a stockholders' agreement.

On its face, the definition of "internal corporate claims" does not include claims under federal securities laws. While it may be argued that fiduciary duties under Delaware law include a duty to not make untrue statements of, or omit to state, material facts, liability under the federal securities laws would be "based upon" such an untrue statement or omission and would not be "based upon" a breach of fiduciary duty. Thus, a fee-shifting provision relating to actions brought by stockholders under the federal securities laws would not appear to violate Section 102 or Section 109 of the DGCL.

The extent to which fee-shifting provisions in corporate documents would be upheld in actions brought by stockholders under the federal securities laws is not clear and is beyond the scope of this Client Alert. The validity of such a provision could depend upon the language of the bylaw itself (for example, whether it is one-sided or mutual), the particular factual circumstances and whether the court concludes that the provision is pre-empted by federal law.

It is noted that federal courts are authorized to impose fee-shifting in certain situations. Section 11(e) of the Securities Act of 1933, as amended (the "1933 Act"), provides that, in any action under Section 11 or any other Section of the 1933 Act, the court may assess costs of litigation (including reasonable attorneys' fees) against the unsuccessful party litigant if the court believes that the suit or the defense, as the case may be, was without merit. Section 18(a) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), and Section 323(a) of the Trust Indenture Act of 1939, as amended, contain similar provisions.

In addition, Section 27(c) of the 1933 Act and Section 21D(c) of the 1934 Act, both of which were part of the Private Securities Litigation Reform Act of 1995, as amended, provide that the court, upon final adjudication of any private action under either of such Acts, shall review compliance by the parties (both plaintiffs and defendants) and attorneys with the requirements of Rule 11(b) of the Federal Rules of Civil Procedure and impose sanctions on parties and attorneys who are found to have violated Rule 11(b). There is a rebuttable presumption that such sanctions include attorneys' fees.

Forum Selection

Another controversial issue in corporate governance has been the inclusion in a corporation's certificate of incorporation or bylaws of a provision limiting the jurisdiction(s) in which actions for breach of fiduciary duty and similar matters may be brought.

The recent amendments to the DGCL validate, and limit, forum selection provisions as follows:

1. New Section 115 of the DGCL now provides, in part, that

   "The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims [as defined in Section 115] shall be brought solely and exclusively in any or all the courts in this State…."

2. Section 115 further provides, however, that

> "…no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State."

Thus, the amendments validate provisions to the effect that internal corporate claims may be brought only in Delaware but invalidate provisions to the effect that such claims may be brought only in a state other than Delaware, as well as a provision requiring that such claims be submitted to binding arbitration. A provision requiring such claims to be brought only in Delaware or a specified other state would presumably be valid. Furthermore, Section 115 does not prohibit the inclusion of a forum selection provision in a stockholders' agreement.

Since "internal corporate claims" presumably do not include claims under the federal securities laws, as discussed above, a forum selection provision relating to actions brought by stockholders under the federal securities laws would not be prohibited by Section 115. The extent to which such a provision would be enforceable under federal law is not clear and is beyond the scope of this Client Alert.

** We would like to thank our Summer Associate Alexander Tiktin for his contribution to this alert.*

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